Office - Supreme Court, U.S.
FILED
OCT 26 1981
ALEXANDER L. STEVAS
CLERK

No. 80-1251

In the Supreme Court of the United States

OCTOBER TERM, 1981

UNITED STATES OF AMERICA, PETITIONER

v.

VOGEL FERTILIZER COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

REPLY BRIEF FOR THE UNITED STATES

REX E. LEE
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

TABLE OF AUTHORITIES

Page

Cases:

Allen Oil Co. v. *Commissioner*, 614 F. 2d 336 ... 5

Bob Jones University v. *Simon*, 416 U.S. 725 ... 8

Fairfax Auto Parts of Northern Virginia Inc., 65 T.C. 798 ... 7

Statutes and regulation:

Internal Revenue Code of 1954, (26 U.S.C.):

Section 401 *et seq.* ... 8
Section 1371 *et seq.* ... 8
Section 1381 *et seq.* ... 8
Section 1551 ... 7
Section 1551(b)(2) ... 6
Section 1563 ... 6, 7
Section 1563(a) ... 6
Section 1563(a)(2) ... 1, 4, 5

Pub. L. No. 88-272, Section 1563(a)(2), 78 Stat. 120 ... 6

Pub. L. No. 91-172, Section 1563(a)(2), 83 Stat. 602 ... 6

26 C.F.R. 1.1551-1(g)(4) ... 7

Miscellaneous:

H.R. Rep. No. 91-413 (Pt. 2), 91st Cong., 1st Sess. (1969) ... 7

Tax Reform, 1969: Hearings Before the House Comm. on Ways and Means, 91st Cong., 1 Sess., Pt. 14 (1969) ... 7

In the Supreme Court of the United States

OCTOBER TERM, 1981

No. 80-1251

UNITED STATES OF AMERICA, PETITIONER

v.

VOGEL FERTILIZER COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

REPLY BRIEF FOR THE UNITED STATES

---

1. Simply put, our submission in this case is that the 80% and 50% tests of Section 1563(a)(2) are separate and distinct portions of the statute that must be independently applied in determining under what circumstances a group of corporations is entitled to only a single surtax exemption. When those tests are separately applied, in accordance with the literal terms of the statute, it is apparent that respondent Vogel Fertilizer and Vogel Popcorn are part of a "brother-sister controlled group."

The function of subparagraph (A) is to require that the corporations in question be closely held, at least to the extent of 80% of their stock. The function of subparagraph (B) is to require that there be identity of ownership to the extent of more than 50% between closely held corporations. Within any single group of five or fewer persons, each requirement must be fulfilled. If, within any such group of five or fewer persons, each requirement is fulfilled, the

statute is satisfied. Perhaps the function and operation of the statute can be best appreciated by examining initially cases that do not fall within it. Consider, for example:

Individuals	Corporations	
	S	T
A	12%	12%
B	12%	12%
C	12%	12%
D	12%	12%
E	13%	13%
F	13%	13%
G	13%	13%
H	13%	13%
	100%	100%

Here we have complete identity of ownership. Any group of five of the shareholders will own more than 50% of the stock in each corporation, in identical holdings. The 50% test of subparagraph (B) is clearly satisfied.

But there is not the required closeness of holding. No group of five or fewer can be found that owns 80% of the stock of either corporation. Subparagraph (A) is therefore not satisfied, and S and T are not members of a "brother-sister controlled group."

On the other hand, consider the following example:

Individuals	Corporations	
	U	V
A	5%	40%
B	5%	30%
C	10%	10%
D	10%	10%
E	30%	5%
F	40%	5%
	100%	100%

The corporations in this example are adequately closely held, because any one of the three groups of not more than five will satisfy the 80% test of subparagraph (A): ABCEF, ABDEF, or ABEF. But no one of these groups provides more than 30% identity of ownership, so the test of (B) is not satisfied, and U and V are not members of a "brother-sister controlled group."[1]

---

[1] A simplified version of this non-qualifying example, with a single group of two might be:

Individuals	Corporations	
	Y	Z
A	80%	20%
B	20%	80%
	100%	100%

The result is different if the pattern is as follows:

Individuals	Corporations	
	W	X
A	15%	-
B	30%	-
C	55%	55%
D	-	30%
E	-	15%
	100%	100%

Each of the corporations is adequately closely held, since each is more than 80% owned by members of the group of five, so (A) is satisfied. There is identity of ownership of more than 50% by a member of the group of five, so (B) is satisfied, and W and X are members of a "brother-sister controlled group." That is what Section 1563(a)(2) commands. To add more is to interpolate provisions that are alien to the terms, the function, and the legislative history of the statute.

Here, the group is composed of shareholders Arthur Vogel and Richard Crain. As in the above example of W and X, there is more than 80% ownership of Vogel Fertilizer and of Vogel Popcorn within the group, so the requirement of subparagraph (A) is satisfied. And by virtue of the 77.49% identity in ownership by Arthur Vogel, the more-than-50% requirement of subparagraph (B) is satisfied. It is clear that 5 or fewer persons owned at least 80% of the combined voting power of stock of each corporation, and more than 50% of the total [voting stock] of each corporation, taking into account the stock ownership of each such person only to the extent such stock ownership is identical with respect to each such corporation. Vogel Fertilizer and Vogel Popcorn are therefore members of a "brother-sister controlled group."

Respondent and the *amici*, however, resist the force of the literal terms of the statute. By adding unstated conditions to the 80% test, they contend that the 80% test is not satisfied unless each member of the group owns some stock in each corporation. In support of this argument, respondent invokes (Br. 40-42) the "last antecedent doctrine" and claims that the final phrase in subparagraph (B)—"taking into account the stock ownership of each such person only to the extent that such stock ownership is identical with respect to each such corporation"—modifies the earlier statutory phrase "5 or fewer persons."

To be sure, the phrase in subparagraph (B) necessarily makes reference to the "5 or fewer persons" who comprise the shareholder group. But the last antedecent doctrine cannot operate to transport the phrase "each such person" from the 50% test of subparagraph (B) and make it operative for purposes of subparagraph (A). Surely if Congress wanted to introduce the commonality requirement of the 50% test into the 80% test it could have easily done so by employing the phrase "each such person" in subparagraph (A) as well. But Congress did not do so. Instead, it added the 50% test to the statute as a separate subparagraph presumably so that it would be separately applied. The structure of Section 1563(a)(2) therefore refutes respondent's "highly strained and convoluted reading of the statute." *Allen Oil Co.* v. *Commissioner*, 614 F. 2d 336, 339 (2d Cir. 1980).

2. The foregoing reading of the statute is confirmed by its underlying policy. In enacting Section 1563 in 1964 and amending the statute in 1969, Congress sought to establish an objective basis for disallowing multiple surtax exemptions of closely held corporations with such a degree of identity of ownership as to allow their common owners to operate the corporations as a single economic entity. It cannot be doubted that respondent Vogel Fertilizer and Vogel Popcorn are so operated. Arthur Vogel (77.49%) and

Richard Crain (22.51%) together own 100% of respondent, and Arthur Vogel owns 87.5% of Vogel Popcorn. Given these shareholdings, it is plain that Arthur Vogel can operate both corporations as a single economic entity.

Indeed, as we have pointed out, respondent and the decision below concede that if Richard Crain owned a single share of Vogel Popcorn, the two corporations would constitute a brother-sister controlled group, even under their reading of the statute. But Richard Crain's ownership of a single share of Vogel Popcorn would not in any manner enhance the ability of Arthur Vogel to operate both corporations as a single economic entity. There is absolutely no evidence that Congress intended Section 1563(a) to turn on such minute differences. Accordingly, the logical inference to be drawn is that the Treasury Regulation's interpretation of the statute furthers the legislative policy.

3. Contrary to respondent's further argument (Br. 10-38), Congress was well aware of the Treasury's intention to issue the Regulations at issue here that directly support our reading of the statute. As we have pointed out in greater detail in our opening brief (at 31-33), when Congress added the 50% test to Section 1563 to expand its coverage, it employed exactly the same words that it previously had used in Section 1551(b)(2) to describe a brother-sister controlled group of corporations.[2] Both the House Committee

---

[2]Contrary to respondent's contention (Br. 5, 15), there is no difference in interpretation of the 1964 and 1969 statutes by the government. The different versions of the statutes relate to different situations. The "ludicrous situation" of respondent's imagining is a product of respondent's misinterpretation. As enacted in 1964, Section 1563(a)(2) defined "brother-sister controlled group" as "[t]wo or more corporations if stock possessing at least 80 percent of * * * voting power * * * or * * * of * * * value * * * of each of the corporations is owned * * * by one person" (Pub. L. No. 88-272, 78 Stat. 120). Since the "group" of owners could consist of only one person, it was not necessary to provide explicitly for identity of ownership. No feat of interpretation could

Report and the Treasury's Technical Explanation are in accord on this point that "[t]he stock ownership test [for brother-sister controlled groups] would be the same test employed in section 1551(b)(2) * * *." H.R. Rep. No. 91-413, Pt. 2, 91st Cong., ~~1st Cong~~., 1st Sess. 76 (1969). See also *Tax Reform, 1969: Hearings Before the House Comm. on Ways and Means*, 91st Cong., 1st Sess., Pt. 14, 5168 (1969). At that time, Trea. Reg., Section 1.1551-1(g)(4) (26 C.F.R.) included an example (Example 4) indicating that the ownership of a person could be taken into account for purposes of the 80% test although he did not own stock in each of the corporations and was therefore not considered for purposes of the 50% test. Given the identical language of the two statutes and the inference to be drawn from the Section 1551 Regulations that supports the validity of the Section 1563 Regulation at issue here, there is no basis for respondent's claim that the latter Regulation goes beyond anything that the Treasury presented to Congress in 1969.

4. Finally, respondent relies (Br. 34-35) on the Tax Court's observation in *Fairfax Auto Parts of Northern Virginia, Inc.* v. *Commissioner*, 65 T.C. 798, 805 n.5 (1976), that the Treasury Regulation would permit a shareholder (such as Arthur Vogel) of one corporation to "surprise" his fellow shareholder (such as Richard Crain) by forming a second corporation and thereby cause the loss of

---

bring Corporation X, solely owned by A, and Corporation Y, solely owned by B, within the statutory definition. When the ownership group was enlarged from "one person" in the 1964 statute to "5 or fewer persons" in Section 1563(a)(2), as amended in 1969 (Pub. L. No. 91-172, 83 Stat. 602), it was necessary to be explicit on identity of ownership, and subparagraph (B) supplied that need. Under the amended statute, if A and B owned all of the stock of Corporation X, and C, D, and E owned all of the stock of Corporation Y, it was the failure to meet the requirements of (B) that kept the two corporations from coming within the statutory definition. Within the group of "5 or fewer persons" all of the stock of each corporation is owned.

the first corporation's surtax exemption. As respondent views the matter (Br. 6-7). "Surely Congress did not intend that such an unfair surprise be visited upon * * * Richard Crain, under what must be a common fact pattern, because of actions taken by an individual over whom he has no control." Respondent therefore concludes (Br. 6) that "equitable considerations" support its claim to a full surtax exemption.

But the tax law is replete with instances in which the uncontrolled actions of a single individual can affect the tax liability of others. For example, a shareholder in a Subchapter S corporation can transfer shares to a person who is disqualified, thereby revoking the Subchapter S status of the corporation and altering the tax expectations of his fellow shareholders. See Section 1371 *et seq.* of the Code. Similarly, the managers of a pension plan may act in a manner that results in its disqualification and therefore cause onerous tax consequences to the participants. See Section 401 *et seq.* The same is true for an agricultural cooperative. See Section 1381 *et seq.* of the Code. And, finally, the managers of a tax-exempt institution may engage in activities that cause the revocation of its status and thereby jeopardize the deductible character of contributions made by third parties. See *Bob Jones University* v. *Simon*, 416 U.S. 725 (1974). While careful counsel may seek to mitigate the impact of such adverse tax consequences by requiring agreements to refrain from disqualifying activities and by providing for indemnification for breach of such agreements, there is no principle in the tax law that prevents the actions of one individual or entity from affecting the tax liability of another. At all events, respondent has made no showing that Arthur Vogel organized Vogel Popcorn after respondent came into existence without the knowledge of

Richard Crain. There is accordingly no legal or factual basis for respondent's "equitable" claim to a full corporate surtax exemption.[3]

CONCLUSION

For the reasons stated above and in our opening brief, the judgment of the Court of Claims should be reversed.

Respectfully submitted.

REX E. LEE
Solicitor General

OCTOBER 1981

---

[3]It is also true that under respondent's interpretation of the statute, a person in Richard Crain's position could "surprise" a person in Arthur Vogel's position by acquiring a single share of stock of the corporation in which the person in Arthur Vogel's position owned 51% of the stock.